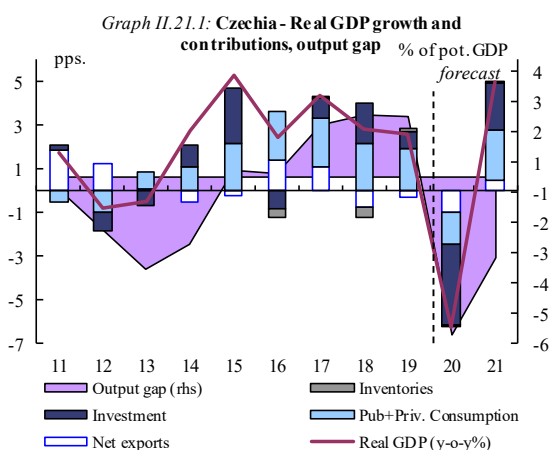


## 21. CZECHIA

Czechia's economy is set to suffer a strong hit from the COVID-19 outbreak in 2020, as external demand drops and lockdown measures disrupt economic activity. Real GDP is expected to gradually recover in 2021, although it is unlikely to rebound to 2019 levels. Inflation is expected to decrease amid falling oil prices and demand. In parallel, public finances are forecast to deteriorate significantly, as the government's measures provide support against the economic impact of the pandemic.

### Economic growth to plummet in 2020

Before the COVID-19 pandemic, Czechia's economy was on track for a gradual slowdown after several years of sustained growth. This was largely reflected in weakening confidence indicators and a drop in industrial production throughout 2019 and early 2020.



In 2020, the COVID-19 pandemic is expected to lead to a sharp decline in GDP growth of -6¼%. Nonetheless, the magnitude of the fall will largely depend on the effectiveness of government measures and how quickly global demand rebounds after the shock. Czechia implemented lockdown measures early and will likely lift them progressively starting in early May, considering the current evolution of the pandemic. Thus, output is estimated to shrink by over 9% in the second quarter of 2020. The economy should then gradually recover from the third quarter onwards, but the impact on sectors such as transport, hospitality and tourism may last longer. In 2021, GDP is expected to grow by 5%, and recover the loss only partially. The upturn is forecast to be mainly driven by an increase in private consumption and investment.

Private consumption, which was the driver of growth in past years, is set to drop by around 4½% in 2020. Households will likely defer consumption

of durable goods and build precautionary savings as uncertainty remains high. Unemployment is expected to be impacted as well, reaching around 5%, but its increase should be cushioned by the government's measures, a previously tight labour market and a low share of temporary contracts.

### Investment and trade to nosedive in 2020 and recover only partially

Investment is expected to contract sharply in 2020 by nearly 15%, owing to value-chain disruptions, increasing uncertainty and workforce shortages during the lockdown period. Reinforcing already prevalent structural challenges, the automotive sector is set to be particularly hit by the COVID-19 crisis, fuelling a large drop in equipment investment. On the other hand, the fall in construction investment may be softened by the sector's order stock and its reliance on local supply-chains. However, expectations of declining house prices could limit the scope for recovery in construction investment even in 2021. Public investment growth should be negligible in 2020, but is expected to rebound significantly in 2021.

Trade is set to be impacted strongly due to the structure of Czechia's exports. The highly cyclical nature of some sectors (e.g. the automotive sector) will likely cause a drop in the trade balance of goods in 2020, before gradually recovering in 2021. Services should also be strongly affected, although its trade balance is expected to decrease only mildly in 2020 and to remain stable in 2021.

### Inflation expected to decrease slightly

Headline HICP inflation is forecast to fall to 2.3% in 2020 and 1.9% in 2021. The decline in oil prices will likely translate into a drop in energy prices, while the easing of wage growth may put additional downward pressure on inflation, particularly on prices of services. However, a rather weaker Czech crown and a likely rise in food prices is expected to moderate the fall in inflation over the forecast horizon.

### Public finances to deteriorate significantly in both 2020 and 2021

After four years of budgetary surpluses that lowered the public debt-to-GDP ratio to around 30%, the general balance is expected to turn sharply negative this year. To help households and firms through the pandemic, the Czech government adopted a stimulus package amounting to around 2% of GDP in direct aid. It also launched public guarantee schemes of up to 17% of GDP which are assumed to entail no immediate budgetary impact.

The combined loss in tax revenues due to the drop in economic output and the adopted policy measures are expected to generate a fiscal deficit of 6¼% of GDP in 2020. On the revenue side, direct taxes should be the most impacted, particularly corporate tax receipts. On the expenditure side, the largest pandemic relief

measures include financial support to the self-employed and a short-time subsidy working scheme. This expenditure will add to the previously agreed increases in public wages, pensions and other social benefits. This fiscal expansion will also likely lead to an increase in interest expenditures. Public investment, on the other hand, is likely to stagnate, as there is a standstill in terms of new infrastructure projects.

On a no-policy change scenario, the general government deficit is expected to improve slightly in 2021, to 4% of GDP. The recovery in tax revenue is expected to be modest, whereas current expenditures are expected to continue growing. Public investment is projected to increase sharply, as the current EU funds cycle is drawing to a close. The general government debt is projected to increase from around 31% of GDP in 2019 to almost 40% by 2021.

Table II.21.1:

#### Main features of country forecast - CZECHIA

	2018			Annual percentage change						
	bn CZK	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	5323.6		100.0	2.8	2.5	4.4	2.8	2.6	-6.2	5.0
Private Consumption	2525.8		47.4	2.2	3.6	4.3	3.2	3.0	-4.6	4.0
Public Consumption	1059.0		19.9	1.3	2.7	1.3	3.4	2.6	3.6	1.5
Gross fixed capital formation	1363.7		25.6	3.0	-3.1	3.7	7.6	2.8	-14.5	9.6
of which: equipment	593.0		11.1	4.4	-2.5	3.4	8.5	0.3	-25.0	20.9
Exports (goods and services)	4177.1		78.5	8.7	4.3	6.7	4.4	1.2	-13.3	9.6
Imports (goods and services)	3836.9		72.1	8.2	2.8	5.9	5.9	1.7	-13.0	9.6
GNI (GDP deflator)	5026.8		94.4	2.4	2.7	4.7	3.5	3.7	-7.2	5.4
Contribution to GDP growth:		Domestic demand		2.2	1.4	3.2	4.0	2.7	-5.1	4.5
		Inventories		0.1	-0.4	0.1	-0.4	0.2	-0.1	0.0
		Net exports		0.4	1.4	1.1	-0.8	-0.3	-1.0	0.5
Employment				0.4	1.6	1.6	1.3	0.7	-3.1	0.8
Unemployment rate (a)				6.9	4.0	2.9	2.2	2.0	5.0	4.2
Compensation of employees / head				4.5	4.0	6.4	8.0	6.2	2.5	4.2
Unit labour costs whole economy				2.0	3.1	3.6	6.5	4.2	5.9	0.0
Real unit labour cost				0.2	1.8	2.1	3.8	0.7	4.4	-1.6
Saving rate of households (b)				11.6	11.6	9.5	10.9	10.7	16.2	12.9
GDP deflator				1.8	1.3	1.4	2.6	3.5	1.4	1.6
Harmonised index of consumer prices				2.2	0.6	2.4	2.0	2.6	2.3	1.9
Terms of trade goods				-0.1	1.0	-1.4	-0.1	0.2	-0.5	0.0
Trade balance (goods) (c)				-0.5	5.4	5.0	4.2	4.2	3.4	3.5
Current-account balance (c)				-3.5	0.1	0.3	-0.1	0.7	-1.5	-1.0
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-2.5	0.6	0.8	0.8	1.1	-0.8	0.0
General government balance (c)				-3.3	0.7	1.5	0.9	0.3	-6.7	-4.0
Cyclically-adjusted budget balance (d)				-3.5	0.7	0.8	0.1	-0.5	-4.6	-2.9
Structural budget balance (d)				-	0.7	0.8	0.1	-0.5	-4.6	-2.9
General government gross debt (c)				32.3	36.8	34.7	32.6	30.8	38.7	39.9

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.